No. 2385

UNITED STATES CIRCUIT COURT OF APPEALS

NINTH CIRCUIT.

THOMAS M. SHIELDS,
Plaintiff in Error,

vs.

COLUMBIA RIVER LUMBER COMPANY, A CORPORATION,
Defendant in Error.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

Brief for Defendant in Error.

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STATEMENT OF THE CASE.

In 1911 the defendant in error owned about 50,000 acres of land in Chelan county, Washington, upon a portion of which stood more or less timber. Early in that year, it employed Mr. Charles A. Murray, of Tacoma, to obtain a purchaser therefor, on the basis of $200,000.00 for the property, Murray to receive a commission of 5% (Rec., p. 57).

In connection with Mr. Murray's attempts to find a purchaser, he became connected with Thomas Winsor, the assignor of the plaintiff in error, and at his request Winsor made an examination of the property. An attempt was

made to sell the property to Lambert & Hoban (Rec., p. 50), but this effort failed, and later Mr. Winsor found Mr. F. P. Kellogg as a prospective purchaser.

The record does not clearly show just when the arrangement with Mr. Murray for a $200,000.00 price on a 5% commission was abandoned, but it does show in every subsequent transaction that this particular form of employment was abandoned, and that a $205,000.00 net price was given to, and acted upon by, Mr. Murray and those who worked with him.

The proposition put up to Mr. Kellogg was for a price of $225,000.00, and Mr. Murray had it arranged so that the excess of $20,000.00 over and above the net price to the defendant in error, was to be divided between himself, Mr. Steeves and Mr. Winsor, as follows: Mr. Murray, $5,000.00, Mr. Steeves, $5,000.00 and Mr. Winsor, $10,000.00, and it now appears that at the time in question Mr. Kellogg, the proposed purchaser, had an arrangement with Mr. Winsor whereby one-half of the $10,000.00 to be paid by Kellogg, and which was to go to Winsor, as his share of the profit or commission, was to be turned back by Winsor to Kellogg himself (Rec., pp. 151-52).

The negotiations resulted in the execution of three different papers on the 23rd day of August, 1911.

First, an option agreement between the defendant in error and Kellogg (Rec., pp. 67-71).

Second, a memorandum escrow agreement directed to the Union Trust Company of Chicago, Illinois (Rec., pp. 71-73), and

Third, a memorandum escrow order or agreement in modification of the one last above mentioned (Rec., pp. 64-66).

The *first* document mentioned is an option for four months running to Kellogg, giving him personally the right to buy the entire tract of land in question for the sum of $225,000, paying $80,000 upon delivery of deed, $145,000 on or before five years from date of delivery of deed, $140,000 thereof to be paid to the defendant in error, and $5,000 directly to Charles A. Murray.

It further provides that a deed should be executed and placed in the hands of the Union Trust Company running to Kellogg personally, covering said property, to be delivered to him upon the performance of certain conditions as follows:

1. Kellogg to organize a corporation under the laws of the State of Washington, to which he should transfer the title to the land so to be deeded to him.

2. That corporation to raise money on a bond issue upon the title, and pay $80,000 to the defendant in error through the Trust Company.

3. Kellogg to furnish and deliver through the Trust Company a surety bond guaranteeing the payment of the balance of $145,000 and interest within the five years.

4. Kellogg to further secure said payment by placing in escrow with the Trust Company, the entire Capital Stock of the corporation organized by him.

5. That the corporation was to agree that $2.00 per thousand feet of timber manufactured should be used to retire the bonds, and a further $2.00 per thousand applied toward payment of the unpaid purchase price, together with all other profits upon the operation until the purchase price was paid.

6. Kellogg was to act as manager of the corporation on a salary.

The document *second* above referred to is an escrow order or agreement directing the disposition of the money, $225,000, when paid in by Kellogg to the Trust Company, which escrow was prepared with the idea of depositing the same with the Union Trust Company as soon as Kellogg furnished the surety bond, and thus showed himself to be able to that extent at least to take up the option. Kellogg never furnished that bond (Rec., pp. 150-1). Consequently the escrow agreement was never used or filed with the Union Trust Company; no corporation under the laws of Washington in accordance with this option was ever organized by Kellogg, no deed ever made to Kellogg, and no stock of such a corporation ever came into existence.

The *third* document was another escrow order directed to the Union Trust Company (Rec., p. 64), whereby the documents one and two are referred to as if set forth therein in full, and whereby the Trust Company was to be directed to set aside $15,000 of the certificates of stock in the corporation Kellogg was to organize under the laws of Washington, when the Trust Company should receive the same from Kellogg, for the benefit of Winsor to the extent of $10,000, and Steeves $5,000, and that when the $145,000 and interest should be paid by Kellogg in cash to redeem all said certificates, it was to pay to Winsor $10,000 plus interest, and to Steeves $5,000 plus interest; the other $5,000 of the $20,000 excess over the net price—the difference between $205,000 net to the defendant in error and the price of $225,000 which Kellogg was to pay,—having been already arranged for by the direction to pay $5,000 to Mr. Murray. The original of this document has been transmitted to this court, and the attention of the

court is particularly called to the interlineations in writing of the following phrases:

"In event of said Kellogg's carrying out completely the said proposed sale," and "In manner and form following."

A copy of this paper was given to said Winsor, and the others held awaiting Kellogg's deposit of the $150,000 surety bond; this never having been done, the document was never delivered to the Union Trust Company.

About the 29th of November, 1911, Kellogg having utterly failed to take up the option or put himself in a position to do so, and being wholly unable to give the bond, so notified the defendant in error, and further negotiations resulted in a new option being given to Kellogg on the 29th of November, 1911 (Rec., p. 122). By the terms of this option, a corporation was to be formed under the laws of Nevada, with certain restricted powers, capitalized at $450,000, $150,000 Preferred, $300,000 Common, the land was to be deeded to it by defendant in error, and all of the stock was to be issued to the defendant in error, and to be at all times owned by it, subject to the optional right given Kellogg to purchase the stock.

A bond issue was to be made and $80,000 of the proceeds was to be turned over by the new company to the defendant in error, and the balance expended in improvements upon the property. Upon the completion of the bond issue, one-third of the common stock was to be assigned to Poole & Company for financing the operation.

The defendant in error then granted unto Kellogg "the right and option at any time within five years from Jan. 1st, 1912, to purchase of and from the defendant in error, the $150,000 of Preferred Stock and $200,000 Common Stock of the corporation for the sum of $145,000 and interest." The agreement provided that "upon the full pay-

ment of which sum and interest by said second party (Kellogg) or his heirs or assigns to the said first party in accordance herewith, the said stock shall be assigned by the said first party to the said second party or to his order or estate."

Then follow provisions respecting the handling of the property, Kellogg to be manager and to be paid a salary, details as to what should be done with the proceeds of the manufacturing operation, and then the following (Rec., p. 129):

> "9. This agreement shall not grant the said second party any rights or interests whatsoever in or to any of the said lands above referred to but shall be held and considered to be for no other purpose than to give him an opportunity to purchase the said common stock and preferred stock under the conditions above set forth."

Pursuant to this document, the F. P. Kellogg Lumber Company was formed under the laws of Nevada, capitalized as stated, the lands deeded to it, the bond issue was completed and the stock of the corporation was issued in the name of the defendant in error, the Columbia River Lumber Company, except one qualifying share which was issued in the name of Kellogg so he might become a trustee and officer, and that share was immediately retransferred to the defendant in error (Rec., p. 145).

Some improvements were made, and the money spent, and Kellogg found that he was unable to go any further for lack of a large sum of money.

Kellogg never paid one dollar to the defendant in error upon such option to purchase the stock, and fell down entirely in his attempt to work the matter out.

This resulted in his surrendering his option and stepping out of the company in 1913 (Rec., p. 138).

Kellogg never exercised the option to purchase the stock, never paid anything thereon (Rec., p. 149), and the $80,000 received by the defendant in error was borrowed upon its own property.

On May 7th, 1912, Winsor and Kellogg, without the knowledge of the defendant in error, fixed up Exhibit No. 22 (Rec., p. 141), whereby Winsor consents that certain stock which he claims should have been issued under the agreement of August 23rd, 1911, and delivered to the Union Trust Company, might be delivered to the Columbia River Lumber Company instead, "and in this respect waiving no other or further conditions in said agreements of August 23rd, 1911" (Rec., pp. 64-67-71).

Later Winsor demanded the issuance and delivery of Preferred Stock in the F. P. Kellogg Lumber Company for $10,000 direct to him, which demand resulted in the letter of Nov. 7th, 1912, from Mr. Selover for the defendant in error, Exhibit No. 16 (Rec., pp. 100-103), wherein the position of the defendant in error was made reasonably plain. The Kellogg option of November 29th, 1911, was still in force, and, waiving its technical rights, the defendant in error offered to deposit $20,000 of the Preferred Stock of the Kellogg Company with a trustee with an order and direction to Mr. Kellogg to pay to that trustee the proportion of the unpaid purchase price, which would be credited to that stock, totaling $20,000 in all, and with the direction to the Trust Company that "when Kellogg has in all respects fully carried out his contract with us, and has received and paid for all the Preferred Stock, that then and in that event, the sum of $20,000 shall be paid to you three gentlemen in certain proportions."

Winsor was not satisfied with this, but demanded the stock, which was refused, and he thereupon, in April of

1913, assigned his rights to the plaintiff in error, Exhibit 17 (Rec., p. 107). This action was then commenced for conversion of the stock of the F. P. Kellogg Lumber Company, and resulted in a non-suit and a judgment of dismissal.

ARGUMENT.

I.

WINSOR NEVER EARNED ANY COMMISSION, WHETHER IN STOCK OR OTHERWISE.

II.

WINSOR NEVER BECAME ENTITLED TO HAVE ANY STOCK DELIVERED TO HIM AT ANY TIME, HENCE NO CONVERSION WAS POSSIBLE.

I.

Kellogg claimed to have a high personal responsibility (Rec., p. 53), and under the option of August 23rd, 1911, was to furnish a surety bond to guarantee the payment of $145,000 and interest in case he took up the original option; in addition all the stock was to be deposited with the Union Trust Company as trustee as further security. Under such option, the title to all these lands was to be actually turned over to Kellogg himself by deed; he was to become the owner of it, and was then to turn it over to a corporation of the State of Washington to be formed by him, which corporation was to issue all its stock to Kellogg. He was then to deposit that stock, put up a surety bond to secure his remaining indebtedness of $145,000, after paying the defendant in error $80,000, which he intended to borrow upon what would then be his property.

Such a proposed sale would, if carried out by Kellogg, have been a real sale of the land to a party found and produced by Winsor. The document, Exhibit 13 (p. 64), as drawn and presented by Winsor to the defendant in error, obligated the defendant in error to pay $15,000 as commission. It read (page 65), "The Columbia River Lumber Company have agreed to pay as a commission for perfecting the sale, the sum of $15,000."

This the defendant in error refused to sign, and it was modified so as to make the payment conditional upon actual and complete payment by Kellogg, by inserting after the word "agreed" in the above quotation, the following: "In the event of said Kellogg's carrying out completely the said proposed sale"; and further limited Winsor's right to receive payment by inserting the words "in manner and form following," thus expressly limited his right to receive payment to the time "when the cash shall be paid to redeem said certificates."

The agents, having a net price agreement, were not entitled to anything until the defendant in error actually received something over and above the net price of $205,000. If they sold for $205,000 only, they got nothing. If for $225,000, they would receive $20,000, after and when the same should have been paid. All the arrangements made were based on this situation.

To issue stock and turn it over to Winsor would have given him part of defendant's property for nothing.

However, the option of the 23rd of August was never carried out, no corporation was ever formed pursuant to it, Kellogg could not put up the bond or satisfy the defendant in error as to his responsibility. So the defendant in error, in November of 1911, absolutely refused to go into any transaction such as that involved in the August 23rd

document, or which contemplated turning over to Kellogg or to a corporation owned by him the title to this property without payment or security.

A new option, that of November 29th, was given Kellogg after he had completely fallen down on the first one, whereby for convenience a new corporation was formed, called the F. P. Kellogg Lumber Company, of which all of the stock was held and owned by the defendant in error, even including the one share of stock nominally issued in Kel logg's name; the defendant in error turned over its title to this new corporation, which it owned and the ownership of which it never parted with. Through that corporation it borrowed some money and paid to itself $80,000 thereof.

It gave Kellogg an option to buy all of the stock of the concern, excepting $100,000 par value of common stock, which went to the bankers. It did not give him any option to purchase or own the real estate, but expressly denied such right. It retained possession of all its property and moneys, borrowed and otherwise, through the new corporation, and Kellogg's position was that of a hired man paid a salary for doing his work, with an option to purchase the major part of the stock of the concern.

Kellogg's claim of responsibility had vanished, his $150,000 surety bond was unobtainable, and he certainly was not ready, able and willing to buy anything. The situation was the same as if the defendant in error itself had given Kellogg the option to buy all its outstanding stock; the formation of a new corporation being merely a matter of convenience, gave him no rights, and the transfer to it was not a sale of the property in any sense of the word.

II.

This action is not for a commission, but for the conversion of stock owned by Winsor, to the possession of which he claims to have been entitled in 1912 and 1913.

It seems plain that the stock which was to be deposited with the Union Trust Company was never to become the property of Winsor in any event.

That stock was to be issued by a corporation organized by Kellogg, and was to be issued to, and become the property of Kellogg; he was then to deposit it as additional security with the Trust Company for the payment of the balance of the purchase price, $145,000 and interest. If, and when he should redeem it, the stock should be released to Kellogg and a portion of the money was to go to Winsor. Setting aside by the Trust Company of that much of Kellogg's stock, deposited as collateral, was mere bookkeeping. The stock was not to be in the name of the defendant in error at all; it was to be assigned by Kellogg to the Union Trust Company as security. The defendant in error was, under no circumstances, to receive the stock unless Kellogg defaulted, and his surety bond became worthless, in which event defendant in error might foreclose its lien and become the owner of the stock; in other words, might again become the owner of its own property, without having received a dollar therefor.

Winsor was never to receive stock, but money, and that only in event Kellogg made good.

If it had been intended that Winsor should receive stock, why was it carefully provided that he should receive interest upon the $10,000 from the time the option was taken up until the time the money was paid? Under the Kellogg option, this might be five years, and such interest has no

relation whatever to the ownership of stock. Indeed, the company which issued the stock became the company which was obligated to pay the interest and the obligation to pay interest to Winsor on this very $10,000 was a liability against the stock itself.

If we consider the Preferred Stock in the new corporation, the F. P. Kellogg Lumber Company, to be in the hands of the defendant in error, held for Winsor's benefit under the terms of the August 23rd agreements—and this is the view most favorable to the plaintiff in error—it must be so held under the conditions and limitations to be found in those documents. Indeed, in Winsor's alleged consent to the defendant in error's holding this stock instead of turning it over to the Trust Company, we find (Exhibit 22, page 142), Mr. Winsor says: "And in this respect, *waiving no other or further conditions in said agreements of August 23, 1911.*"

It will be noted that this exhibit is dated May 7th, 1912, long after the agreement of November 29th, 1911, with Kellogg, which the plaintiff in error now urges was in and of itself all that was necessary to entitle him to the delivery to him of the stock in question. Yet in May of 1912, Winsor over his own signature, directly acknowledges that whatever rights he has with respect to the stock of the F. P. Kellogg Lumber Company, in the hands of the defendant in error, depend upon the agreement of the 23rd of August, 1911.

Upon this theory, defendant in error was holding this stock as trustee to await the completion by Kellogg of his contract, the taking up of his option to buy the stock strictly in accordance with the agreement of August 23rd, and particularly of Exhibit 13 (page 64), upon which plaintiff in error stands. A refusal on the part of the

defendant in error to issue and deliver the stock to Winsor was therefore absolutely justified as being in the teeth of the agreement of August 23rd, which plainly states that the stock assigned as collateral, was to be held until it was paid for by Kellogg, and then returned to him, and the money, as such, when received, paid to Winsor. Indeed, that agreement contemplates the receipt by Winsor of *money* and nothing else, and that only upon condition that it be received from Kellogg.

There is not one word in any one of those agreements which shows a willingness on the part of the defendant in error, under any possible state of circumstances, to pay one dollar of its own money to Winsor for doing anything, or that Winsor expected it to do so. He was to have a portion of the purchase money secured by him for the defendant in error from Kellogg when he had secured it, and not before. The stock he never was to get.

Had it been the intention of the parties that he was to have stock, they would have said so, and it would have been wholly unnecessary to place stock in the hands of a trustee if it belonged to Winsor. Winsor has no more right to claim the stock from the possession of the defendant in error, than he would have had, at any time during the five years had the Union Trust arrangement been made use of, to have demanded it from the Union Trust Company. Manifestly that company would have committed a breach of trust had it given out to Winsor upon his demand stock in the Kellogg corporation, issued in Kellogg's name and assigned to it, the Trust Company, as trustee, as collateral to the obligation to the defendant in error to pay $145,000 and interest. That the Trust Company would be held liable for refusing to so breach the contract under which it held the stock, is unthinkable; and the most that can be

said for the contention of the plaintiff in error is that the defendant in error is in the same position that the Union Trust Company would have been had the original deal been carried out.

But the original transaction was abandoned through Kellogg's default, and the rights which Kellogg received under the option of November 29th, 1911, were as nothing compared to those he would have received had he put up the bond and carried out the original agreement. Then he would have become the owner of the property. Now he became the owner of nothing, and had a mere option to purchase some stock. That stock never became Kellogg's, and its ownership left the status of the property just where it was before the transfer was made, to-wit: in the defendant in error. For the defendant in error to be required to turn over the stock to Winsor would be merely to give him a part interest in its own property without receiving the slightest benefit in return. Instead of procuring a sale of the land, at best he procured a man who took one option, and then another, and fell down completely on both.

To say that he would have been entitled to the stock under the original agreement from the Union Trust Company would be stretching the facts and the law too much, but what shall we say of a demand that the defendant in error part with $10,000 of its own stock, which it never in any document had agreed to turn over to anyone except Kellogg? In what document or line is there a word entitling Winsor to the possession and ownership of any preferred stock in the F. P. Kellogg Company, owned by the defendant in error?

The attitude of the defendant in error, as shown by the letter of Mr. Selover of November 7th, 1912 (pages 100-103), was a willingness to waive any technical rights, and

to deposit in some trust company certificates representing this stock "with an order and direction to Mr. Kellogg to pay into that trust company the proportion of the unpaid purchase price which would be credited to that stock, totaling $20,000 in all, with a direction to the Trust Company that when Kellogg has in all respects fully carried out his contract with us, and has received and paid for all the preferred stock, that then and in that event, the sum of $20,000 shall be paid to you three gentlemen in certain proportions. This will give you your money as soon as you become entitled to it, to-wit, as soon as the transaction is completed, and until that time no one knows whether it will be completed or not."

This attitude was strictly in accordance with the escrow papers of August 23rd, 1911, and would have been a proper answer for the Union Trust Company to have made had the demand been made upon it. More than that, it showed a very liberal regard for the rights of Winsor and the others.

Nothing can be clearer upon this point than the conclusion arrived at by the court below (Rec., p. 19):

> "This stock was not to be paid to these parties. If it had been considered that they were entitled to anything at that time, the stock would have been delivered to the parties instead of putting it in the Union Trust Company. But there was still something to follow, and, what was to follow was simply what was interlined there, the carrying out of the proposed sale by the payment of the money, and then the Union Trust Company was authorized to pay to these parties, not the stock, but the money, when it was paid by Kellogg. Now, then, in the memoranda that was made by Winsor on May 7th, 1912, he says he is willing that the Columbia River Lumber Company shall hold the stock instead of the Union Trust Company, and therefore, as the testimony shows here, I conclude that the Columbia River Lumber Company has this

stock, and is still holding it. Mr. Kellogg has stated that he has not paid anything; that he has abandoned the property; that he was short of funds, and needed more funds, and the parties have declined to advance him more funds, and it was concluded that he had better surrender all the property, which he did. He never paid a cent in, and never got a cent out, other than his compensation."

It is respectfully submitted that the judgment of the court below was right, and should be affirmed.

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